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ABSTRACT

The Stafford Loan Program (formerly called the Guaranteed Student Loan Program) makes three kinds of student loans for postsecondary education: Stafford Loans, Supplemental Loans for Students (SLS), and Parents Loans for Undergraduate Students (PLUS). Stafford loans are low-interest loans based on financial need, while SLS and PLUS loans are not based on financial need. Each loan is insured by one of 55 state or nonprofit guaranty agencies. Guaranty agencies can collect an insurance premium on each loan; they reimburse lenders for 100% of defaulted claims; and they serve as lenders of last resort. The Department of Education administers the program; reinsures the guaranty agencies for 100% of defaulted loans, except in those cases where the agency's default rate exceeds 5%; and makes interest payments to lenders for Stafford loan borrowers while they are in school. Figures for growth in number of loans, increases in dollar amounts of loans, increases in number of defaults, increases in loans to students attending proprietary schools, and default rates of students attending proprietary schools are provided. The report also notes actions taken by the Congress and the Department of Education to reduce loan defaults, and lists 11 General Accounting Office reports concerning the program. (JDD)

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THE STAFFORD STUDENT LOAN PROGRAM

Statement of Franklin Frazier
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United States General Accounting Office

Before the
Subcommittee on Permanent Investigations
Committee on Governmental Affairs
United States Senate

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SUMMARY OF GAO TESTIMONY
BY MR. FRANKLIN FRAZIER
ON THE
THE STAFFORD STUDENT LOAN PROGRAM

The Stafford Loan Program (formerly called the Guaranteed Student Loan Program) makes three kinds of student loans: Stafford Loans, Supplemental Loans for Student (SLS), and Parents Loans for Undergraduate Students (PLUS). Stafford loans are low interest (currently 8 percent) loans that are made on the basis of financial need; the federal government pays interest on the loan while students are in school; and students generally begin repayment within 6 months after leaving school. SLS and PLUS loans are not based on financial need; interest rates vary annually (currently 12 percent); both can provide assistance up to \$20,000; and repayment of principal and interest generally begin 60 days after the loan is made.

In 1989 the Stafford Loan Program made over 4 million loans in the amount about \$12 billion. The Program accounts for about 54 percent of student aid provided by the Department of Education. Both public and private postsecondary schools participate in the program. Each loan is insured by one of the 55 state or nonprofit guaranty agencies. Guaranty agencies can collect an insurance premium of up to 3 percent for each loan; they reimburse lenders for 100 percent of defaulted claims; and they serve as lenders of last resort. The Department of Education administers the Program; reinsures the guaranty agencies for 100 percent of defaulted loans, except in those cases where the agencies default rate exceeds 5 percent; and makes interest payments to lenders for Stafford loan borrowers while they are in school.

GROWTH IN LOANS, DEFAULTS, AND PROGRAM COSTS

Between 1983 and 1989 program loans have grown from about \$7 billion to over \$12 billion annually--an 83 percent increase. Similarly, the number of loans increased 56 percent from 3 million to 4.7 million. During the same period defaults increased over 338 percent from \$444 million to about \$1.9 billion. In terms of program costs, defaults increased from 10 percent in 1983 to about 36 percent in 1989. Loans to students attending proprietary schools have risen from 17 percent in 1983 to about 34 percent.

In 1989 we reported that proprietary school borrowers accounted for 22 percent of all loans, but 44 percent of the defaults. Studies by Education in 1986 and 1987 also indicate that the default rate at proprietary schools is significantly higher than for other kinds of schools that participate in the Stafford program.

STUDIES BY GAO

Attached to my statement is a list of our studies on student financial aid programs. These studies contain several

recommendations that could improve the program and reduce the default rate. Some of our recommendations have been adopted by the Congress and the Department, e.g., actions have been taken to standardize schools' policies on refunding tuition and fees, and to delay loan disbursements to schools and students until 30 days after enrollment and an indication of satisfactory completion. However, our recommendations regarding risk sharing by lenders and guaranty agencies have not been adopted.

ACTIONS BY THE CONGRESS AND DEPARTMENT TO REDUCE LOAN DEFAULTS

Loan consolidation and the denial of loans to schools with default rates over 30 percent are two recent actions taken by the Congress that could reduce the default rate. The Department has recently published regulations that address the default problem. For example, requiring schools with default rate over 20 percent to establish a default management plan is a major initiative of the department.

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to discuss the Stafford Student Loan Program. This program is of extreme importance to students seeking a postsecondary education and to the future workforce of our nation. However, in recent years it has been the subject of greater scrutiny and much of that has focused on those student-borrowers who have defaulted on their loans.

I will focus my comments today on (1) how the Stafford program works, (2) the growth in loans guaranteed and defaulted, and (3) past GAO recommendations, and recent legislative and regulatory changes.

MAJOR FINANCIAL AID PROGRAMS

The Department of Education offers seven major student financial aid programs. These programs were established by title IV of the Higher Education Act, as amended, and include Pell grants, supplemental educational opportunity grants, college work study, Perkins loans, Stafford loans, Parent Loans for Undergraduate Students (PLUS), and Supplemental Loans for Students (SLS). For fiscal year 1989, the Department estimates that the seven programs made almost \$18 billion of student aid available through over 9.8 million awards. (See table 1.)

Table 1: Aid Available and Number of Awards for the Seven Major Financial Aid Programs (Fiscal Year 1989)

<u>Aid program</u>	<u>Aid available (in millions)</u>	<u>Number of awards (in thousands)</u>
Pell grants	\$4,863.0	3,302
Supplemental grants	442.4	633
Work study	780.3	835
Perkins loans	884.0	826
Stafford	8,431.0	3,324
PLUS	689.0	218
SLS	<u>1,817.0</u>	<u>676</u>
Totals	\$17,906.7	9,814

The Stafford Student Loan Program, formerly called the Guaranteed Student Loan Program, consists of Stafford, PLUS, and SLS loans. These three kinds of loans represented 60 percent of federal student aid made available in fiscal year 1989. These loans are guaranteed by the federal government against borrowers' death, disability, bankruptcy, and default. Banks, credit unions, and savings and loan associations are the primary providers of student loans.

The three types of loans differ somewhat in their terms and conditions and I would like to highlight some of these differences.

Stafford Loans

These loans--formerly called guaranteed student loans--are the largest of the three loan types (77 percent of aid available in 1989) and have been available since the program was created as part of the Higher Education Act of 1965. The loans are based on the student-borrower's financial needs which means that all borrowers must show financial need regardless of their income to qualify. Other key facts are:

- Interest rates for new borrowers are 8 percent for the first 4 years of repayment then 10 percent after that.
- Maximum loans limits are \$17,250 for undergraduates and \$54,750 for graduate students.
- Borrowers generally have a 6-month grace period after leaving school before repayment begins.

PLUS Loans

These loans enable parents to borrow funds for each dependent student (those who are not generally responsible for their own financial support) enrolled at a school. These loans basically started in 1981 and are not needs-based. Other key facts are:

- Interest rates are variable and are determined once a year with a ceiling of 12 percent, which is the current rate.
- Maximum loan limits for each dependent are \$4,000 per year to a total of \$20,000.
- There is normally no grace period and repayment must generally begin within 60 days after disbursement.

SLS Loans

These loans are available to independent undergraduates (those students generally responsible for their financial support) and graduate students. These loans basically started in 1982¹ and like PLUS loans are not needs-based. Also like PLUS loans, SLS loans generally have the same interest rate, borrowing limits, and no grace period. However, some of the provisions for SLS loans were recently changed in legislation and I will discuss those changes later in my statement.

¹SLS loans were part of the Auxiliary Loans to Assist Students program prior to 1986 and had terms and conditions similar to SLS loans, and both are reported by the Department as SLS loans.

HOW THE STAFFORD STUDENT LOAN PROGRAM OPERATES

The program involves five parties including students, schools, lenders, guaranty agencies, and the Department of Education. I would like to provide some information on each party.

The Student

The student initiates the loan process. The student provides eligibility information to the school, applies to a lender for the loan after eligibility is determined, arranges for repayment with the lender, and repays the loan. Stafford loan borrowers receive a federal subsidy throughout the period of their loans including a low interest rate and make no interest payments on the loan while they attend school. When the student completes or otherwise leaves school, he or she is to start repayment. Between fiscal year 1983 and 1989, the number of Stafford program loans guaranteed each year increased from about 3 million to almost 4.7 million.

The School

The schools verify students' eligibility and the amount of financial aid needed. There are about 8,000 schools participating in the Stafford program. The kinds of schools participating in the program are categorized by: 2-year public, 2-year private, 4-year public, 4-year private, and proprietary (for profit trade and vocational) schools.

The Lender

Lenders make loans and under the programs' guaranty provisions, must exercise proper care in making, servicing, and collecting them, and follow the applicable program requirements. Lenders bill the Department each quarter for the federal interest subsidy payment for the loans they hold. These payments include the

students' interest while they are in school. Also, during the life of the loan, the lender receives a special allowance payment that is intended to provide it with a near-market rate of return. They file default claims with the guaranty agency, but cannot be reimbursed for their claims until borrowers have been at least 180 days delinquent.

There are about 13,000 lenders participating in the program. As of September 30, 1988, they held about \$45.1 billion in outstanding loans. Approximately \$89 billion in guaranteed student loan commitments were made since the program began in 1965. Most of the loans are held by few lenders. For example, 25 lenders had 52 percent of the \$45.1 billion outstanding, and one organization--the federally chartered Student Loan Marketing Association--had 25 percent (\$11.3 billion) of the total. (See table 2.)

Table 2: Ten Largest Holders in the Stafford Loan Program (as of September 30, 1988)
(Dollars in millions)

<u>Loan holder</u>	<u>Amount outstanding</u>
Student Loan Marketing Association	\$11,317.6
Citibank (New York)	1,891.5
California Student Loan Finance Corp.	1,314.0
Chase Manhattan Bank (New York)	967.4
Nebraska Higher Education Loan Program	837.0
Chemical Bank (New York)	729.7
New England Education Loan Mktg. Corp.	587.7
Florida Federal Savings Bank	574.0
Marine Midland Bank (New York)	506.1
Manufacturers Hanover Trust Company	424.3

The Guaranty Agency

The guaranty agencies carry out several tasks, including: (1) issuing guarantees on qualifying loans so that when a borrower fails to repay his or her loan due to death, disability, bankruptcy, or default, the lenders can be reimbursed for their

claims; (2) charging students an insurance premium of up to 3 percent of the loan; (3) verifying that lenders properly service and attempt to collect loans before the agency pays default claims; and (4) remitting to the Department its portion of monies the agencies' subsequently collect from defaulted borrowers.

If lenders choose not to make loans to eligible students--especially those attending schools with high default rates--the guaranty agency must find another lender or become the "lender of last resort" itself. There are 55 guaranty agencies--state agencies or private nonprofit organizations--that administer the program in the 50 states, District of Columbia, the Pacific Islands, Puerto Rico, and the Virgin Islands.

The Department of Education

The Department of Education is responsible for administering the Stafford program and for overseeing the activities of the various participants. It pays lenders interest subsidies, and reimburses guaranty agencies for up to 100 percent of lenders' claims. To partially offset program costs, the Department charges borrowers a 5 percent origination fee and receives payments from the guaranty agencies on collections from reinsured defaulted loans.

STAFFORD PROGRAM PERSPECTIVE

Now I would like to provide a perspective on the Stafford program in terms of loan growth, defaults, and program costs. The Department provided us with the information we used to calculate loan growth, defaults, and program costs. The data cited for fiscal year 1989 are estimates from the Department.

Loan Growth

The Stafford program has grown during the 1980s, especially since 1983. The amount of new loans guaranteed² through fiscal year 1989 for the entire program increased 83 percent since 1983. Because PLUS and SLS loans were basically just starting during this period, their growth rates--391 percent and 1,893 percent, respectively--are expected to be high. (See table 3.)

Table 3: Loan Volume Has Substantially Increased Since Fiscal Year 1983
(Dollars in millions)

<u>Type of loan</u>	<u>Loans guaranteed</u>		<u>Percent increase</u>
	<u>Fiscal year 1983</u>	<u>Fiscal year 1989</u>	
Stafford	\$6,537	\$9,581	47
PLUS	151	741	391
SLS	<u>106</u>	<u>2,113</u>	1,893
Total program	\$6,794	\$12,435	83

Default Growth

Defaults have risen dramatically. Overall, defaults for the total program increased 338 percent in the last 6 years. Stafford loans defaults went up 266 percent from fiscal year 1983 through fiscal year 1989, while PLUS and SLS loan increases were 6,525 percent and 111,221 percent, respectively. (See table 4.)

²Loans guaranteed represent commitments made to lenders by guaranty agencies. However, actual loan disbursements would be less in those instances where students decide not to enroll in school and the loan was cancelled.

Table 4: Defaults Have Dramatically Increased Since Fiscal Year 1983
(Dollars in thousands)

<u>Type of loan</u>	<u>Default payments to lenders</u>		<u>Percent increase</u>
	<u>Fiscal year 1983</u>	<u>Fiscal year 1989</u>	
Stafford	\$444,022	\$1,623,000	266
PLUS	483	32,000	a
SLS	265	295,000	a
Total program	\$444,770	\$1,950,000	338

^a Default rates for PLUS and SLS loans increased 6,525 percent and 111,221 percent, respectively, over the 6-year period. However, these loans were relatively new and the eligibility for SLS loans had been liberalized within the last 3 years. But by all indications, default rates are rising rapidly for those two types of loans.

Although both loan volume and loan defaults have increased dramatically over the last 6 years, the increase in defaults has far exceeded the increase in loan volume. For example, as I pointed out earlier, total loans increased 83 percent from fiscal year 1983 through 1989, while defaults increased 338 percent--four times faster than loan volume. Also, for all three kinds of loans, defaults substantially exceeded loan growth during the last 6 years. (See table 5.) The Department attributes a large portion of these default increases to the four-fold increase in Stafford loans from 1977 to 1983.

Table 5: Increases in Defaults Greatly Exceeded Increases in Loan Volume Since Fiscal Year 1983

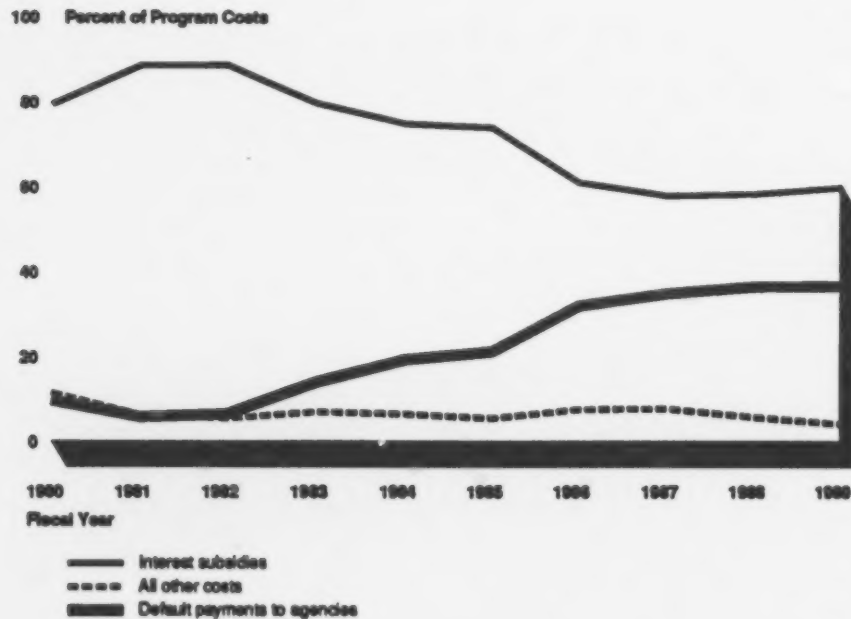
<u>Type of loan</u>	<u>Loan increase</u> (Percentages)	<u>Default increase</u>	<u>Times exceeded</u>
Stafford	47	266	5.7
PLUS	391	6,525	16.7
SLS	1,893	111,221	58.8
Total program	83	338	4.1

Program Costs

As a portion of total program costs³, defaults have risen from about 10 percent in fiscal year 1980 to 36 percent in 1989. Interest subsidies have decreased as a portion of total costs to where they were about 60 percent of the program's costs in 1989. Other costs, including the Department's expenses for other claims, such as death and disability, have leveled off to 4 percent of program costs in 1989. (See figure 1.)

³The default costs represent claim payment amounts to guaranty agencies.

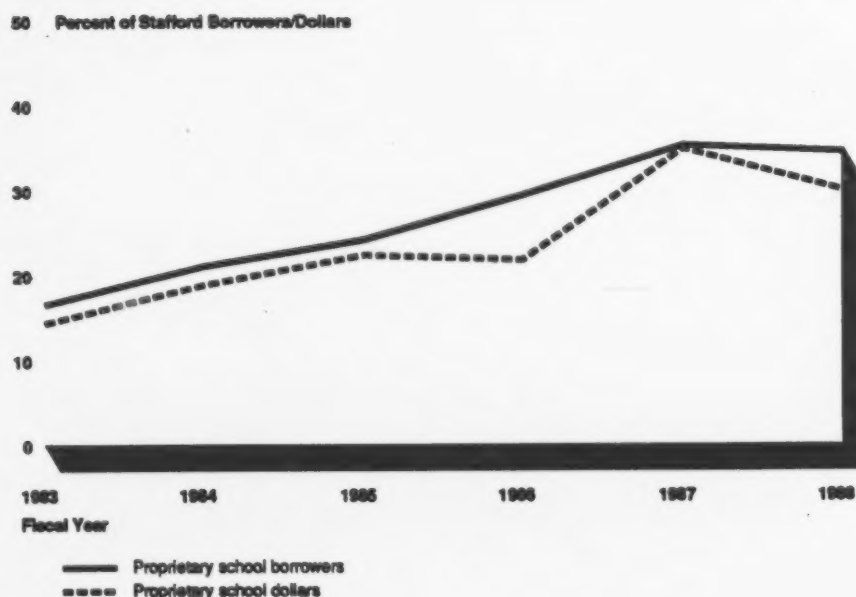
Figure 1: Defaults Are Becoming A Greater Portion of Program Costs



CONCERNS WITH PROPRIETARY SCHOOLS

Students from proprietary schools are receiving an increasing share of Stafford loans. The Department reported that in fiscal year 1983, proprietary school borrowers comprised 17 percent of all borrowers and received 14 percent of the loan dollars. However, 5 years later, 34 percent of such borrowers received 30 percent of Stafford loans--double the 1983 share, although these figures declined somewhat in 1988. (See figure 2.)

Figure 2: Proprietary School Borrowers Are Receiving An Increasing Share of Stafford Loans

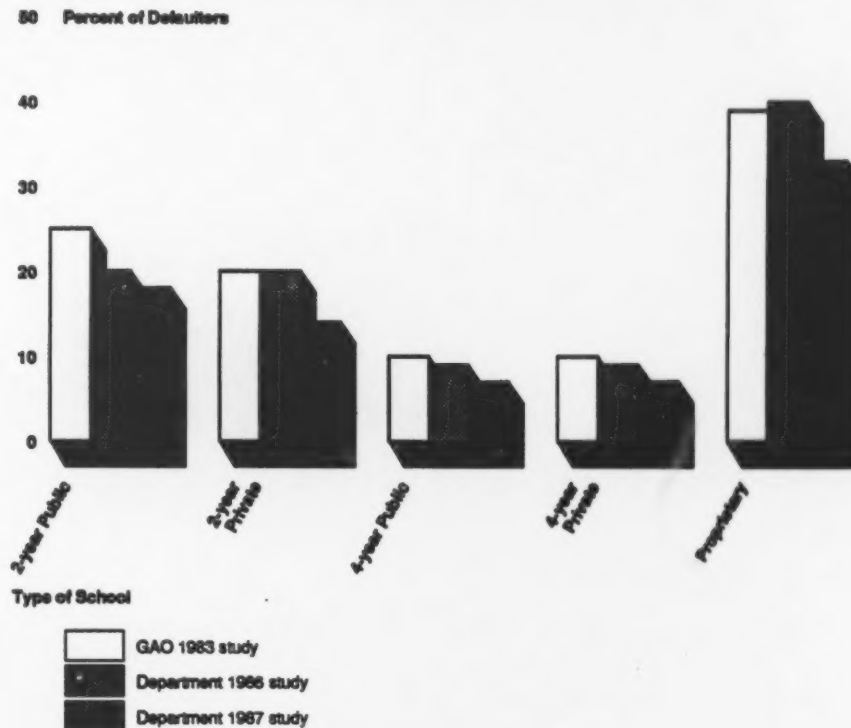


The default rate for proprietary school borrowers is greater than the rate for borrowers from other schools. In July 1989 we reported⁴ that while proprietary school borrowers comprised about 22 percent of borrowers who received their last loan in 1983, they accounted for 44 percent of defaults as of September 30, 1987. Over that 4-year period, student default rates for the five kinds of schools ranged from 10 percent for 4-year public and private schools, to 39 percent for proprietary schools. The Department of Education reported similar results in two recent studies of school default rates. Both studies determined which borrowers, by kind of school, were in default after entering repayment. The results

⁴Guaranteed Student Loans: Analysis of Student Default Rates At 7,800 Postsecondary Schools, GAO/HRD-89-63BR, July 5, 1989.

showed proprietary school borrowers had the highest default rates: 40 percent for 1986; while declining to 33 percent for 1987. (See figure 3.)

Figure 3: GAO and Department Studies Found That Proprietary School Borrowers Have the Highest Default Rates



GAO HAS ISSUED MANY REPORTS ON THE STAFFORD PROGRAM

You asked us to provide information about our previous work on the Stafford program. I have attached a listing of our recent products to my statement. During the last 4 years, we have issued 10 products on this program, many of which recommended ways to

reduce defaults and other program costs. For example, one report⁵ contained 30 options for strengthening the program and included suggestions directed to the five participants. Some of these options have been incorporated into legislation or regulations. Some of the key suggestions we made which would reduce default costs were to:

- Standardize policies for refunding tuition and fees to students who fail to complete enrollment periods. (Action taken.)
- Delay loan disbursements to students and schools for some period after classes begin. (Action taken.)
- Require that lenders share the default risk. (Action not taken.)
- Increase guaranty agencies' default risk or restructure the way in which they share this risk. (Action not taken.)
- Require that guaranty agencies share all default payments on reinsured loans with the Department. (Action not taken.)

A significant option which the Congress enacted was extending the IRS income tax refund offset program. This program offsets defaulted borrowers' income tax refunds if they do not have repayment arrangements with the guaranty agencies. In the last three tax years, this program has recovered over \$500 million from student loan defaulters.

THE CONGRESS AND DEPARTMENT ACTIONS TO REDUCE LOAN DEFAULTS

When the Higher Education Act was reauthorized in October 1986, many changes were enacted to address the default issue. Among the more significant changes included establishing a loan consolidation

⁵Guaranteed Student Loans: Potential Default and Cost Reduction Options, GAO/HRD-88-52BR, January 7, 1988.

program which allows borrowers with high student loan debt to stretch out their repayment periods for as many as 25 years, compared to normal 10-year repayment periods for Stafford loans. This program is designed to reduce defaults by allowing borrowers' to make lower monthly payments over longer periods of time. Another provision enacted through reauthorization mandated the reporting of student loan information to credit bureaus. Through this provision, borrowers who are delinquent or do not repay their student loans would have this information made part of their credit histories, which should encourage those who may contemplate defaulting to repay.

The Congress continues to make legislative changes directed at reducing defaults. Most recently, as part of the Omnibus Budget Reconciliation Act of 1989 (Public Law 101-239), it enacted several major changes--especially to the SLS program. For example, one of the most significant changes is that effective January 1, 1990, no SLS loans can be made to borrowers (unless they were previously enrolled at the institution on date of enactment and had already received an SLS loan) attending schools that have default rates--as determined by the Department of Education--of 30 percent or more.

The Department has also been active in trying to reduce defaults. One of its most significant actions was publishing regulations in November 1986 creating specific requirements for lenders and guaranty agencies to follow in collecting delinquent and defaulted loans. It more recently issued additional regulations in June 1989 allowing the Department to use school default rate information to initiate sanctions against schools exceeding certain default rate thresholds. For example, schools with default rates above 20 percent must develop and submit default management plans to address the causes of defaults, or face possible sanctions by the Department.

FUTURE GAO PLANS THAT ADDRESS DEFAULTS

Despite many legislative and regulatory changes that have been made to deal with the default issue, there is still much to be done. We have several ongoing and planned assignments that relate to defaults. For example, we plan to initiate work soon on the accreditation, certification, and eligibility processes that schools undergo to become eligible to participate in the Stafford program so that students attending these schools can receive such federal aid.

Mr. Chairman, that concludes my statement. My colleagues and I would be happy to answer any questions you or other Subcommittee members may have.

RELATED GAO PRODUCTS

Supplemental Student Loans: Who Are the Largest Lenders?
(GAO/HRD-90-72FS, will be issued on Feb. 21, 1990).

Supplemental Student Loans: Who Borrows and Who Defaults
(GAO/HRD-90-33FS, Oct. 17, 1989).

Guaranteed Student Loans: Comparisons of Single State and Multistate Guaranty Agencies (GAO/HRD-89-92, July 11, 1989).

Guaranteed Student Loans: Analysis of Student Default Rates at 7,800 Postsecondary Schools (GAO/HRD-89-63BR, July 5, 1989).

Defaulted Student Loans: Preliminary Analysis of Student Loan Borrowers and Defaulters (GAO/HRD-88-112BR, June 14, 1988).

GAO's Views on the Default Task Force's Recommendations for Reducing Default Costs in the Guaranteed Student Loan Program
(GAO/T-HRD-88-7, Feb. 2, 1988).

Guaranteed Student Loans: Potential Default and Cost Reduction Options (GAO/HRD-88-52BR, Jan. 7, 1988).

Guaranteed Student Loans: Analysis of Insurance Premiums Charged by Guaranty Agencies (GAO/HRD-88-16BR, Oct. 7, 1987).

Guaranteed Student Loans: Legislative and Regulatory Changes Needed to Reduce Default Costs (GAO/HRD-87-76, Sept. 30, 1987).

Defaulted Student Loans: Private Lender Collection Efforts Often Inadequate (GAO/HRD-87-48, Aug. 20, 1987).

Defaulted Student Loans: Guaranty Agencies' Collection Practices and Procedures (GAO/HRD-86-114BR, July 17, 1986).